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Lionberger, Isaac Henry

The passing crisis, a normal readjustment

St. Louis

1920

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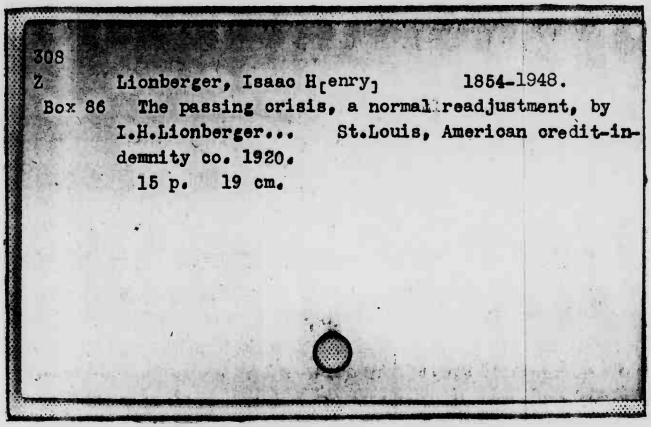
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Z Lionberger, Isaac H[enry] 1854-1948.
Box 86 The passing crisis, a normal readjustment, by
I.H.Lionberger... St.Louis, American credit-in-
demnity co. 1920.
15 p. 19 cm.

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TECHNICAL MICROFORM DATA

FILM SIZE: 35mm REDUCTION RATIO: 10:1 IMAGE PLACEMENT: IA (IIA) IB IIB

DATE FILMED: 3-4-97 INITIALS: MS

TRACKING # : MSH 21943

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The
PASSING CRISIS

A Normal Readjustment

By
I. H. LIONBERGER
CHAIRMAN AMERICAN CREDIT-INDEMNITY CO.

PUBLISHED BY
THE AMERICAN CREDIT-INDEMNITY CO.
ST. LOUIS, MO.
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To be had of the Company on application

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The Passing Crisis

A Normal Readjustment

July, 1920.

In a small book on crises written in 1919, an attempt was made to weigh various influences then operating with a view to proving that a crisis was not likely to occur in this country in the immediate future. Since that time many things have occurred. Rates of interest have advanced, the rise in the prices of commodities has been arrested, imports have increased and deflation has begun. So numerous have been the manifestations of reaction that many people have become alarmed. This writer predicts an immediate disaster, that one a crisis not later than August 1921, and there are bankers who announce with confidence a serious disturbance in the autumn of the current year.

Having considered recent events and the arguments of these men of affairs, I have been unable to agree with the prophets of calamity and therefore venture to lay before the reader the various reasons which induce me to be more hopeful.

What are called cycles in business affairs may be conveniently divided into distinct periods of progress, varying in length, which merge into each other:—

1. Dullness which is characterized by slack trade, small profits, unemployment, low wages, low rates of interest and cheap goods.

2. Revival—characterized by increasing consumption, improving trade, greater production, advancing wages, better rates of interest, increasing profits, few failures.

3. A boom—characterized by extravagance, very active trade, very great profits, very high wages, increasing cost, tight money and very high prices.

4. A crisis—characterized by an arrest in trade, falling prices, forced liquidation, many failures, restricted production, low wages, abundant money, cheap goods and dullness.

It is unnecessary to again explain either the causes or the order of these events. Crises have occurred at approximately equal intervals of time in every civilized country for more than a century, and are likely to occur while men are men and do business on credit. A boom has always

been followed by a crisis and a crisis by a period of prolonged readjustment.

What now concerns us is to ascertain whether the boom through which we are undoubtedly passing is apt to collapse in the immediate future. Extravagance was never so reckless, wages and profits were never so high, the cost of goods was never so great, prices were never so high, credit was never more strained; and in addition to these ordinary incidents of a boom, we have to reckon with an unprecedented inflation of the currency. No one who considers these facts only and remembers what has always happened under like circumstances, can avoid the conviction that a reaction is inevitable.

There are, however, other factors which are not less significant, and upon them I think may be predicated an argument which should persuade to hope rather than fear. The most influential of these factors is the universal scarcity. Commodities are scarce and capital is scarce. The demand for goods of all sorts, the need for them, was never so great. The productive capacity of the belligerents was for a time greatly crippled by the exigencies of war, and since the war, although great strides have been made, production has not provided nearly enough goods to meet the demand. Prices are still exorbitant, but not with-

standing the high cost of living many people and all governments are more extravagant than ever before. Look where we may, we can nowhere find any symptom of over-production. Excessive taxation has not completely crippled industry nor prevented the accumulation of capital, but the cost of improvements is so great that wise men are reluctant to undertake enlargements and betterments. Capital is still very hard to get, and labor is scarce; and it is altogether doubtful whether the supply of goods can under such circumstances in the near future overtake the demand, even at prices asked.

I cannot think the recent price-cutting indicated a surplus of goods, for it may with more reason be attributed to the condition of the money market. After years of hesitation, the reserve banks have courageously confronted the problems of deflation and by high rates of interest are compelling the reduction of obligations. No goods have thus far been forced to sale at a loss. Merchants are still solvent, and few failures have occurred. The pressure of high rates on the goods market has somewhat eased the public discontent, but it has also distinctly eased the credit situation. The reserve banks are becoming stronger; the private banks are becoming stronger; the tendency of rates of interest is rather downward than up-

ward; and the argument to be drawn from contrary tendencies is not now cogent. No panic can occur under existing conditions, for while goods are salable at more than cost and collections are good, traders can pay their debts.

We are, in fact, now passing through a crisis—not a violent, shocking and injurious crisis, but a gradual, wholesome readjustment to pre-war conditions. The crisis began in April. It was inaugurated by the reserve banks in time, while trade was active and profitable. The measures taken were efficacious. The pressure will not be relaxed. Billions of reserve notes must be paid by borrowers with the proceeds of goods sold; and they are being paid gradually. Speculation has been curtailed. Profits are being devoted to ordinary business undertakings and should serve to increase the resources or curtail the debts of business men. The municipal bond craze has abated. Railroads are borrowing, but their borrowing should increase their efficiency and earn money. Transportation is improving. The expected advance in freight rates should restore the credit of the roads and tend to improve their service.

All of these considerations are important. The panics of the past have been the results of powerful and dangerous tendencies which rising

rates of interest have failed to check. Today like tendencies are being checked, and if time be allowed there can be no doubt that we shall escape a violent readjustment.

I am aware that the problems of the immediate future are delicate in the extreme and that all the prudence and sagacity of the financial and business world will be required to avoid calamity. But recent events afford evidence that what the situation requires is being done. Business has met the strain resulting from the policy of the reserve banks successfully. High rates of interest have been followed by a slow but steady liquidation. No goods have thus far been sold at an actual loss. The money market, although strained to the uttermost in April, has gradually improved not withstanding the enormous fiscal operations of the government. Credits, frozen by traffic congestion, are being dissolved. Many millions of currency have been retired. The improvement in the condition of the member banks and of the reserve system has been distinct. Enough capital seems to be forthcoming not only to meet the exigencies of the federal treasury but for all legitimate demands. Merchants and manufacturers have become prudent. There is still a ready market for all goods at a profitable price. Although imports have increased, exports are still great.

The high prices of which we complain are still low enough to attract buyers from abroad. Our inflation is less than that which afflicts foreigners. Exchange on London is worth 25% less than par, francs and lira and marks are greatly depreciated. Merchants and manufacturers have become very rich by reason of a long period of unexampled prosperity, and are therefore stronger than ever before. The National Reserve Board has given the widest publicity to its firm determination to compel a gradual liquidation, and the business world after a brief shudder has adjusted its affairs to such policy.

We are, therefore, passing through the crisis successfully. There are of course dangers ahead. Somehow we must manage to retire two billions of reserve notes, and as these notes were loaned to borrowers who became liable for their repayment they must be satisfied by the sale of goods and securities. Nevertheless, goods are in demand and securities can find a market at a price; and two billions of dollars are trifling in comparison with the accumulated resources and current profits of traders. Europe owes us vast sums of money. Its industries are reviving and its shipments to us are increasing. The income so realized should help us to pay our debts to the holders of reserve notes.

Besides the foregoing considerations, there are others of a more general sort which are reassuring. Japan has had its panic, Holland is passing through a crisis, and all those nations which suffered least from the war seem to be embarrassed. This fact is significant. It suggests what we are apt to ignore. Panics are caused by the sudden discovery that the debts of traders cannot be satisfied by the sale of goods on hand. Those nations which were least disturbed by the war have been the first to feel the consequences of its termination. When the war ceased, the markets for their goods at the prices asked were suddenly cut off. The belligerents could not afford to buy, and a crisis was inevitable. The demand for our goods has not been so curtailed. Europe will need our grains and meats and raw material, and continues to buy them. Its demand has tended to steady prices at home. Prices will fall, but they should fall gradually.

It is possible to avoid a panic. Much time must pass before an actual glut in the goods market can occur. We are extravagant, but spending is in a sense the cause of prosperity. If no one wanted goods, none would be produced. The laboring classes are prosperous and are spending freely. The spur to production was never sharper, but we cannot instantly produce as many goods as we

need. The day of abundance approaches, but we have ample time to prepare for it. No preparation is comparable with a gradual and constant reduction in trade liabilities, and the reserve banks are insisting upon such reduction—not suddenly but by prudent preparation and constant liquidation.

There is but one real danger ahead. If the policy of the banks shall result in prematurely cheap money, men will be tempted to think there was no danger and perhaps venture to spread sail before the crisis is over. The Civil War ceased in 1865; a crisis occurred in 1873. The European War of 1804-15 which ended with the exile of Napoleon, was not followed by a panic in England until 1825. The more injurious the war, the greater the waste, the longer the period of subsequent prosperity; yet always, sooner or later, a panic has occurred. The precautions we are now taking should defer such a calamity, but if we, like the English long after the Napoleonic wars, or our ancestors after the Civil War, throwing prudence to the winds and mistaking a period of rehabilitation for an unshakeable economic development, shall bcome bewildered by a prolonged era of high prices, we cannot escape the consequences. A gradual, persistent progress toward cheap goods can alone lead us away from dis-

aster. High cost is evil in itself. Cheapness and abundance are requisite for the general welfare. Somehow, we must reconcile high wages, good profits and cheap goods. There is but one way to do so: either by machinery which saves labor, or by more zealous labor, to increase the output per capita. Small profits on numerous sales will enrich the employer and employee more than great profits on small sales. There are many dumb sufferers who have been practicing a pinching self-denial. Never was there a better market for cheap goods. If we move slowly in the right direction, we shall have no panic; if we turn back, we shall provoke disaster and deserve it.

For the foregoing reasons it is altogether probable that our present prosperity will continue for several years, and that we need not fear a collapse during that period unless, abruptly changing our policy, we abandon caution, resort to further inflation and invoke the penalties of indiscretion. I have attempted elsewhere to prove that a panic is out of the question so long as current debts can be paid in due course with the proceeds of marketable goods. The over-production to be feared is not an abundance of cheap goods, but an accumulation of expensive goods which cannot be sold at the prices asked. The self-denying class,

which is very numerous, is in need of commodities of all sorts, and its buying will begin as soon as goods shall be brought within its reach, and such buying should afford a ready market for all goods likely to be produced for some years to come—always provided they be cheap enough. Efficient production and a gradual but constant reduction in current liabilities are indispensible to safety. Whether they shall be accomplished under the pressure of high rates of interest imposed by the banks or by a prudent regard for the ominous possibilities mentioned by the prophets of disaster, is unimportant. Where both are achieved, no merchant should feel alarmed.

The scarcity resulting from the waste of war, the crippled industries of the belligerents, the urgent need for goods and material of all sorts, the great burdens imposed upon industry by heavy taxation, the long restrained desires of those of limited means who have not been enriched by the war, the insatiable demand for goods at even slightly reduced prices, the immense profits made by traders during a protracted boom in business, the time necessarily required to repair a waste of many hundred of billions of dollars, and the stress imposed upon imprudence by the associated banks of the country, fully justify us in looking forward to several years of profitable enterprise.

The coming strain upon the money market cannot be ignored. To provide funds for merchants and manufacturers and at the same time move the crops, will tax all the resources of the banks. Yet it is incredible that an emergency which all of us expect will not be met successfully. We cannot rely on foreign loans—there is no market for our securities elsewhere—we must depend upon ourselves. If we are prudent, as men should be under such circumstances, a panic is out of the question. Bankers are as a rule wise men. Their co-operation may be relied on. The strain will be brief. We shall meet it successfully.

The foregoing opinion may seem inconsistent with the theory of crises suggested in our pamphlet entitled Commercial Crises, namely: that crises are immediately caused by a fall in prices and the resulting disparity between bills payable and the market values of the goods in which they must be paid. As prices have relaxed and money is extremely tight, it is plausible to conclude that a collapse is imminent.

Nevertheless discounts have not increased, and this anomaly cannot be ignored. Ordinarily when business becomes unprofitable by reason of a fall in prices, discounts increase, because no merchant can meet his maturities under such circumstances. What we observe is most remarkable: an

actual decline in discounts is associated with hardening rates of interest. What is the explanation?

I think it to be this: capital is scarce, that is goods, superfluous wealth of all sorts is scarce; and to this fact we owe the current high rates of interest. Until capital shall have become more abundant, we should not expect a commercial reaction.

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